IDAHO OUTLOOK

NEWS OF IDAHO'S ECONOMY AND BUDGET

STATE OF IDAHO **DIVISION OF FINANCIAL MANAGEMENT** **JULY 2007 VOLUME XXX NO. 1**

The current inflation situation varies depending on whom you ask. Consumers will no doubt tell you inflation is too high. Their opinion is validated by reports that show the overall or "headline" consumer price index jumped 0.7% in May 2007. This increase was the largest rise since September 2005, in the wake of Hurricane Katrina.

Over the last three months energy prices have galloped at an amazing 71% annual pace, a statistic consumers were reminded of every time they filled their cars. The average retail price (including taxes) of gasoline increased from $2.33 per gallon as recently as the last quarter of 2006 to an estimated $3.06 per gallon in the second quarter of this year. Some of this change reflects seasonal factors. This is why on a year-over-year basis gasoline was up just 4.8%.

Some of the price increase can be blamed on inventory problems caused by the frustrating shortage of domestic refining capacity. Unfortunately, increasing refining capacity has been agonizingly slow. However, progress has been made, suggesting gasoline prices may have already peaked. Gasoline prices faded in June, averaging $3.10 per gallon, which was down 2.7% from May. The price of gasoline hovered near $3.00 per gallon in early July, which was 25 cents lower than the Memorial Day price.

Unfortunately, after an initial drop from this year's high, further gasoline price declines will be stymied by rising oil prices. The West Texas Intermediate price of oil is expected to peak at $66.00 per barrel in this year's third quarter, but remain above $60.00 per barrel throughout the forecast period. After peaking in the second quarter of this year, the price of gasoline is expected to bounce between $2.40 and $2.80 per gallon over the forecast period. Overall consumer inflation is forecast to run at 2.5% this year then drop just below 2.0% over the next few years.

The Federal Reserve's recent assessment of inflation is a bit more optimistic than the consumers' view. In its statement following its late June meeting the nation's central bank said, "Readings on core inflation have improved modestly in recent months." Its opinion differs from consumers because the Federal Reserve focuses on the core inflation rate. Since this inflation rate does not include the influences of energy and food prices, it has not risen as fast as overall inflation; it has averaged about 2.0% during this year's first half.

The Federal Reserve has resisted raising interest rates despite wildly swinging energy prices. It has kept its bellwether federal funds rate steady at 5.25% since June 29, 2006. This does not mean the nation's central bank has gone soft on inflation. It will continue to monitor the inflation situation while shaping its policy.

One measure worth watching is employment costs because it is a major determinant of core inflation. It has been remarkably stable in recent years, rising an average of 3.0% in 2006 and 2007, despite a tightening labor market. The direction of employment costs will play a large role in determining the Federal Reserve's policy. Given employment costs are anticipated to continue at about a 3.0% annual pace, the Federal Reserve's short-term direction policy is likely to resemble its current policy.

C.L. "BUTCH" OTTER, Governor

Division of Financial Management
700 W. State Street
PO Box 83720
Boise, Idaho 83720-0032 (208) 334-3900

PRSRT STD
U.S. POSTAGE
PAID
PERMIT NO. 1
BOISE, ID 83720

RETURN SERVICE REQUESTED

Wayne L. Hammon, Administrator

Economic Analysis Bureau
Michael H. Ferguson, Chief Economist
Derek E. Santos, Economist

General Fund Update

As of June 30, 2007

	$ Millions			
Revenue Source	FY06 Actual	**FY07 Executive Estimates** Jan. 06	Jan. 07[1]	FY07 Actual
Individual Income Tax	1,216.4	1,164.3	1,273.6	1,400.2
Corporate Income Tax	194.1	173.5	208.2	190.2
Sales Tax	880.8	850.1	1,084.7	1,077.5
Product Taxes[2]	23.5	15.5	22.2	22.4
Miscellaneous	116.4	104.3	117.6	122.2
TOTAL GENERAL FUND[3]	**2,431.3**	**2,307.6**	**2,706.3**	**2,812.5**

1 Executive estimate as adjusted for 2006 legislative action
2 Product Taxes include beer, wine, liquor, and cigarette taxes
3 May not total due to rounding

General Fund revenue finished FY 2007 $106.2 million ahead of expectations. June brought in an additional $21.1 million, with $18 million of that coming from the individual income tax. Among the big three revenue sources, only the individual income tax exceeded the fiscal year forecast—by a whopping $126.5 million. Both corporate income tax and sales tax fell short of expectations, to the tune of a combined $25.2 million.

Individual income tax revenue was once again the big revenue story, with growth in FY 2007 reaching 15.1%. This follows individual income tax revenue growth of 17.5% in FY 2006 and 14.8% growth in FY 2005. By comparison, Idaho personal income growth in the last three calendar years was 9.8% in 2004, 6.5% in 2005, and 8.5% in 2006. While this income growth is quite strong, it falls far short of the rates of income tax growth. The most likely reason for this spectacular income tax growth is the construction and real estate boom, and in particular capital gains associated with that boom. Capital gains are not included in the definition of personal income, but they are included in the individual income tax base. This is reflected in the filing collection component of the individual income tax, which grew in FY 2007 by 20.2%.

Corporate income tax revenue slid again in June, coming in $1.0 million below the target for the month. The fiscal year ended $18.0 million below the predicted amount, which represents a 2% decline from the previous year. This is the first setback for the corporate income tax since the 46.1% drop in FY 2002. This year's corporate income tax weakness is spread across both filing collections (down $15.7 million) and estimated payments (down $25.7 million), with a significant offset coming from refunds ($16.9 million lower than expected).

Sales tax collections took a slight upturn in June, coming in $0.6 million higher than expected. This leaves the full fiscal year results $7.2 million lower than expected. Sales tax revenue grew by 22.3% in FY 2007, but this was distorted by the sales tax rate increase to 6% that occurred on October 1, 2006. Normalized sales tax growth (i.e., removing the impact of the rate change) was a more realistic 7.3%. This is a sharp deceleration from FY 2006 normalized growth of 12.7%, and reflects the beginning of the housing and real estate correction.

Product taxes gained a little ground in June, finishing the fiscal year $0.2 million ahead of the target, on strength in the tobacco tax component. Miscellaneous revenue gained $3.4 million in June, bringing the full fiscal year excess to $4.7 million. June's excess came from interest earnings (ahead by $2.5 million) and the insurance premium tax (ahead by $1.5 million). The full fiscal year result was dominated by interest earnings, which came in $4.4 million higher than expected.